

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 99-284

December 3, 1999

BANGOR HYDRO-ELECTRIC COMPANY
Selection of Winning Bidder for Sale of
Electricity Capacity and Energy

ORDER

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

Bangor Hydro-Electric Company (BHE) conducted a bid auction process pursuant to Chapter 307 to sell the capacity and energy entitlements to most of BHE's non-divested generation assets and contracts. BHE selected Morgan Stanley Capital Group, Inc. (Morgan Stanley) as the winning bidder. In this Order, we approve the contract entered into by BHE and Morgan Stanley.

II. BACKGROUND

On August 2, 1999, BHE sent to prospective bidders a request for bids (RFB) for most of the entitlement to capacity and energy from its undivested generation assets and contracts. The entitlements are being sold by BHE pursuant to 35-A M.R.S.A. § 3204(4) and Chapter 307 of the Commission's Rules.¹

Through the RFB, BHE solicited offers for the purchase of entitlements to the energy, capacity and certain other benefits provided by certain power purchase agreements (PPAs). The entitlements include 16 MW of BHE's qualifying facility (QF) contract with Penobscot Energy Recovery Company (PERC), a waste-for-energy facility located in Orrington, Maine;² the entire output of the 19.1 MW QF entitlement in the West Enfield hydro-electric facility located in West Enfield and Howland, Maine, and BHE's entitlement to the output of four small, less-than-1 MW QF hydro-electric projects.

On November 15, 1999, BHE submitted its determination of the winning bidder resulting from the Chapter 307 RFB process. BHE selected Morgan Stanley Capital Group, Inc. (Morgan Stanley) for all of the capacity and energy entitlements put out to bid.

During the time period BHE was conducting the above-described Chapter 307 RFB process, the Commission was soliciting proposals to provide standard offer service

¹ The capacity and energy from some of the undivested assets and contracts are exempt from the Chapter 307 bid process and used to supply power to BHE's undivested contract with Unitil.

² The other 6 MW of PERC's output is contractually obligated to Unitil.

to BHE customers. On August 2, 1999, the Commission issued RFBs to potential standard offer providers, and on October 1, 1999, the Commission received proposals in response to the RFB. On October 25, 1999, the Commission issued an Order rejecting all standard offer proposals received for the BHE service territory. The Commission also terminated the BHE standard offer RFB process and immediately initiated a new selection process for standard offer service.

Pursuant to the new selection process, letters were sent to all bidders in the initial Central Maine Power Company (CMP), BHE and Maine Public Service Company (MPS) standard offer processes and to all bidders in the utilities' concurrent Chapter 307 stand-alone auctions. The Commission structured the new selection process to allow bidders to combine a proposal to provide standard offer service with a proposal to purchase utilities' Chapter 307 entitlements.

BHE's Chapter 307 filing includes a description of its review process and the method by which it determined the winning bidder. According to BHE, Morgan Stanley offered a variety of bids based upon financial guarantees for forced outages of all units or of PERC only, and bids based on different delivery points (PTF vs Local Network Service).

As BHE could not assume that any Chapter 307 bid that was linked to an award of the standard offer bid would be successful in winning the standard offer bid, BHE analyzed its Chapter 307 bids on a non-linked basis. BHE chose one of the variety of Morgan Stanley's bids as the unlinked Chapter 307 winner. In the winning proposal, Morgan Stanley bid for transmission at Local Network Service (LNS) with all units financially guaranteed by BHE in the event a resource is unavailable for a forced outage for more peak price hours than off-peak hours, which will be reconciled at the end of the contract term. Morgan Stanley has agreed to purchase power only where LNS is available. Morgan Stanley will pay only for energy, installed capacity (ICAP), operating capacity (OPCAP), and ancillary services as available. BHE also agreed to a financial guarantee that may require the Company to pay replacement power costs to Morgan Stanley at certain times throughout the year, which may cause BHE to incur additional costs.

BHE further explained that due to the must-run nature of the QFs and the fact that the availability term in the agreement with Morgan Stanley states that "under no circumstances will the units be unavailable for economic reasons," the generation units subject to the contract with Morgan Stanley may, at certain times, have to be bid into the pool at a negative price, again perhaps causing BHE to incur additional costs, depending upon market conditions.

In its filing, BHE recognizes that several contract terms create contingent benefits or liabilities for the Company. BHE explains that, in the Company's opinion, it was able to obtain a premium by agreeing to make certain financial guarantees respecting the operability of the units subject to the contract. Overall, the Company believes that even

with the contingent liabilities, the Morgan Stanley bid and contract achieve the highest value obtainable for the Chapter 307 entitlements.

III. DECISION

By a separate order issued in the standard offer RFB proceeding, we rejected all standard offer bids including any linked bids. Therefore, the winner of the Chapter 307 bid process will be made on a stand-alone basis.

By Chapter 307 section 7(I), the Commission must inform BHE whether a contract with Morgan Stanley should be executed. Based upon our review of the proposals received for BHE's Chapter 307 entitlements, the Commission approves the contract between BHE and Morgan Stanley into which BHE has entered subject to the Commission's approval. Our analysis indicates that Morgan Stanley has agreed to purchase these Chapter 307 entitlements from BHE at a levelized price over the 2-year term of the agreement at prices similar to those achieved by CMP and MPS in the other Chapter 307 bid processes. We find no reason to disagree with BHE's assessment that its proposed contract with Morgan Stanley yields the highest value for the entitlements from among the bids, including the variety of Morgan Stanley proposals received by BHE in its Chapter 307 RFB process. Accordingly, the sale of BHE's entitlements to Morgan Stanley should provide the maximum offset to BHE's stranded costs. Moreover, given our knowledge of the NEPOOL markets generally and the Chapter 307 RFB processes conducted by other Maine utilities, we believe that the value received by BHE, including the offsetting value of the contingent liabilities agreed to by BHE, represents a reasonable mitigation of BHE's stranded costs.

We agree with BHE that the financial guarantee granted to Morgan Stanley by BHE is not substantial. BHE's guarantee only arises when forced outages occur in more on-peak hours than off-peak hours. Since there are more off-peak hours than on-peak hours, BHE would incur significant liability only if a short-term outage occurred at a peak capacity time.

Because of the contingent liabilities and other aspects of the contract with Morgan Stanley, BHE requests waivers certain provisions of Chapter 307.

First, in BHE's June 10, 1999 request for Chapter 307 RFB waivers, the Company noted that it would need a waiver of Chapter 307, § 4(C) to permit the Company to offer bidders the right to propose a price for financially guaranteed, firm power related to the PERC contract. On July 16, 1999, the Commission approved a waiver that allows the Company to guarantee a specified amount of capacity and energy from *any* unit at the negotiated prices. The Contract with the Morgan Stanley contains such a guarantee, including (1) an "availability" provision in the Confirmation Agreement providing that the units may not be unavailable to run for economic reasons and that BHE will use "best efforts" to schedule outages during periods acceptable to Morgan Stanley, and (2) an outage provision in the Confirmation Agreement providing financial guarantees in the event a unit is unavailable because of forced outages for

more peak-price hours than off-peak hours. Since these guarantees relate to all of the units, and not just the PERC unit referenced in the Company's initial request for waiver, the Company seeks to expand the scope of the July 16, 1999 waiver to include the right to negotiate a financial guarantee related to all of the units. We believe the scope of July 16, 1999 waiver already permits the guarantees agreed to in the Morgan Stanley contract.

Second, BHE requests a waiver from Chapter 307, section 7(D), because BHE and Morgan Stanley executed an agreement, subject to the Commission's approval. BHE states that the agreement was executed to reflect the fact that the parties have a legally binding agreement, although the contract is contingent upon Commission approval. Chapter 307, section 7(D) directs utilities not to execute contracts with winning bidders until directed to do so by the Commission. We will grant BHE a waiver of section 7(D) because we can see little substantive difference between BHE and the winning bidder agreeing to price terms and the content of a written agreement that would later be executed upon Commission direction and the course followed here, whereby BHE and the winning bidder actually execute the contract that remains contingent upon Commission approval.

BHE also mentions several provisions within the contract with Morgan Stanley that do not specifically appear to need a waiver of Chapter 307, or any other Commission rule, but which may be nonconforming with respect to the form of contract approved earlier by the Commission. These provisions create certain risks to the Company, possibly contingent, but in the Company's view do not significantly affect the value received by BHE under the contract.

Section 10.1 specifies that New York law will control the contract and that neither party may demand a jury trial. In the event of a dispute, it is possible that the New York choice of law provision may add incremental costs to the Company. We agree with BHE, however, that the choice of law provision will not significantly detract from the total value received by BHE.

We have reviewed the other changes to the standard form contract noted by BHE. We accept BHE's judgment that none of the changes should affect the total contract value in a way that warrants choosing another proposal as the winning bid or in a way that undermines the conclusion that the Morgan Stanley contract represents a reasonable mitigation of stranded costs.

Accordingly, it is

ORDERED

1. That the executed agreement between Bangor Hydro-Electric Company and Morgan Stanley Capital Group, Inc., submitted in Bangor Hydro-Electric Company's November 15, 1999 filing in this proceeding, is approved and shall become effective as of the date of this Order.

Dated at Augusta, Maine, this 3rd day of December, 1999.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
 Nugent
 Diamond

THIS ORDER HAS BEEN DESIGNATED FOR PUBLICATION